The original documents are located in Box 67, folder "1976/10/20 HR1144 Tax Code Amendments and Study of Tax Incentives for Recycling" of the White House Records Office: Legislation Case Files at the Gerald R. Ford Presidential Library.

APPROVED
OCT 20 1976

10/20/76

THE WHITE HOUSE

WASHINGTON

ACTION

Last Day: October 20

October 19, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: H.R. 1144 - Tax Code Amendments and Study of Tax Incentives for Recycling

Posted 10/21/76

Archives 10/21/76

Attached for your consideration is H.R. 1144, sponsored by Representative Waggonner.

Under current tax law, social clubs, fraternities and similar organizations are tax-exempt provided (1) they are organized and operated "exclusively" for pleasure, recreation and other non-profit purposes, and (2) no part of their net earnings inures to the benefit of any particular shareholder.

The enrolled bill would:

-- substitute, in lieu of the "exclusive" criterion, the requirement that "substantially all" of a social club's activities must be for non-profit purposes.

-- disallow the corporate dividends received deduction in the case of tax-exempt social clubs, voluntary employees' benefit associations and taxable membership organizations in computing their taxable investment income.

-- deny tax-exempt status to organizations which have a written policy of discrimination on the basis of race, color or religion.

-- amend the Tax Reform Act of 1976 to delay the effective date of the repeal of the tax carry-over provision of the minimum tax for corporations from taxable years beginning after December 31, 1975 to taxable years beginning after June 30, 1976.

-- require the Secretary of the Treasury, in cooperation with the Administrator of the Environmental Protection Agency, to study and report on the effect of tax provisions on recycling solid waste materials.

A detailed discussion of the provisions of the enrolled bill is provided in OMB's enrolled bill report at Tab A.

OMB, Max Friedersdorf, Counsel's Office (Lazarus) and I recommend approval of the enrolled bill.

RECOMMENDATION

That you sign H.R. 1144 at Tab B.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OCT 14 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 1144 - Tax Code Amendments and Study of Tax Incentives for Recycling
Sponsor - Rep. Waggonner (D) Louisiana

Last Day for Action

October 20, 1976 - Wednesday

Purpose

Allows tax-exempt social clubs to earn limited income from nonmember sources; clarifies that the corporate dividends received deduction may not be taken by such organizations; disallows tax-exempt status to social clubs if they discriminate on the basis of race, color, or religion; amends the minimum tax provisions of the Tax Reform Act of 1976; and requires the Secretary of the Treasury, in cooperation with the Administrator of the Environmental Protection Agency, to study and report on the effect of tax provisions on recycling solid waste materials.

Agency Recommendations

Office of Management and Budget	Approval
Department of the Treasury	Approval
Environmental Protection Agency	No objection
Department of Justice	Defers to Treasury
United States Commission on Civil Rights	No comment

Discussion

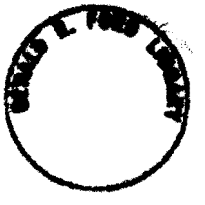
Tax Treatment of Social Clubs

Under current tax law, social clubs, fraternities and similar organizations are tax-exempt provided (1) they are organized and operated "exclusively" for pleasure, recreation and other non-profit purposes, and (2) no part of their net earnings inures to the benefit of any particular shareholder. As a practical matter, the Internal Revenue Service has generally not disturbed a social club's tax-exempt status if its income from outside sources is not more than the higher of $2500 or 5 percent of the total gross receipts of the organization.

The enrolled bill would substitute, in lieu of the "exclusive" criterion, the requirement that "substantially all" of a social club's activities must be for non-profit purposes. The effect of this change would be to allow social clubs to receive up to 25 percent of their annual gross receipts (including investment income) from sources outside their membership without losing their tax-exempt status. However, such nonmember income, including investment income, would still be subject to tax under the unrelated income tax provisions of the Tax Reform Act of 1969.

The bill would also disallow the corporate dividends received deduction in the case of tax-exempt social clubs, voluntary employees' benefit associations and taxable membership organizations in computing their taxable investment income; this would resolve questions raised regarding IRS treatment of dividend income received by such organizations. Treasury supports these two provisions of the bill, which would result in a revenue gain of about $100,000 per year.

Another provision of the bill would deny tax-exempt status to organizations which have a written policy of discrimination on the basis of race, color, or religion. About one-quarter of the 40,000 tax-exempt social clubs are organized on the basis of a common bond of religion or ethnic origin. There is no apparent reason for discouraging social clubs organized on such a basis. The consequences of denying tax-exempt status to these



social clubs would be to compel them to file corporate tax returns. Since such clubs would seldom, if ever, have any taxable net income, the practical effect would simply be an increased paperwork burden imposed on both the clubs and the Internal Revenue Service. However, the attached Treasury views letter notes that the determination of whether an organization has a written policy of discrimination does not, in the view of IRS, present significant problems of administration.

Tax Reform Act Amendments

The bill would amend the Tax Reform Act of 1976 to delay the effective date of the repeal of the tax carry-over provision of the minimum tax for corporations from taxable years beginning after December 31, 1975, to taxable years beginning after June 30, 1976. Treasury supports this provision, noting that a delay in the effective date is warranted because of the hardship (lack of notice) that would otherwise be inflicted on affected taxpayers.

Study of Tax Incentives for Recycling

In cooperation with the Administrator of the Environmental Protection Agency, the Secretary of Treasury would have to study and report to the President and the Congress, within six months of the bill's enactment, on all provisions of the Tax Code which impede or discourage the recycling of solid waste materials. The Secretary's report shall include detailed revenue cost estimates and specific legislative proposals to encourage such recycling.

Treasury states that it has no objection to this provision, but notes that the Department has "already studied the role of tax incentives in encouraging the recycling of solid waste and have found them to be costly and ... ineffective. A further study of the tax incentives for recycling is not likely to change these findings."

James T. Lynn
Director

Enclosures

Signed - 10/20

To - J. Johnston 10-15-76 11:00 A.M.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OCT 14 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 1144 - Tax Code Amendments and Study of Tax Incentives for Recycling
Sponsor - Rep. Waggonner (D) Louisiana

Last Day for Action

October 20, 1976 - Wednesday

Purpose

Allows tax-exempt social clubs to earn limited income from nonmember sources; clarifies that the corporate dividends received deduction may not be taken by such organizations; disallows tax-exempt status to social clubs if they discriminate on the basis of race, color, or religion; amends the minimum tax provisions of the Tax Reform Act of 1976; and requires the Secretary of the Treasury, in cooperation with the Administrator of the Environmental Protection Agency, to study and report on the effect of tax provisions on recycling solid waste materials.

Agency Recommendations

Office of Management and Budget	Approval
Department of the Treasury	Approval
Environmental Protection Agency	No objection
Department of Justice	Defers to Treasury
United States Commission on Civil Rights	No comment

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 15 Time: 1245pm

FOR ACTION: Paul Leach
Bill Seidman
Max Friedersdorf
Bobbie Kilberg
Alan Greenspan approval

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey
Mike Duval

FROM THE STAFF SECRETARY

DUE: Date: October 16 Time: 930am

SUBJECT:

H.R.1144-Tax Code Amendments and Study of Tax Incentives for Recycling

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

x
____ For Your Comments ____ Draft Remarks

REMARKS:

please return to judyjjohnston,ground floor west wing

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

K. R. COLE, JR.
For the President

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

OCT 07 1976

Dear Sir:

This is in response to your request for the views of the Treasury Department on the enrolled bill H.R. 1144.

Section one of the enrolled bill would amend section 501(c)(7) of the Internal Revenue Code of 1954, as amended ("Code"). Under existing law a social club is exempt from taxation if it is "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder." (Emphasis added.) H.R. 1144 amends Code section 501(c)(7) to provide an exemption from taxation for a social club "organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder." (Emphasis added.) The Treasury Department has supported this provision since it makes clear that social clubs may receive some outside income, including investment income, without suffering the loss of their tax-exempt status.

Section one of the enrolled bill also denies the inter-corporate dividends received deduction to voluntary employees' beneficiary associations described in Code section 501(c)(9) and to tax-exempt social clubs described in Code section 501(c)(7) in computing their "unrelated business income", that is, their taxable investment income, and denies such deduction to taxable social clubs or other membership organizations operated primarily to furnish services or goods to members. The Treasury Department has also supported these provisions.

Section two of the enrolled bill provides that organizations which have a written policy of discrimination on the basis of race, color or religion would lose their tax-exempt status under Code section 501(c)(7). The Treasury Department has opposed this provision since approximately one-quarter of the 40,000 social clubs, which are exempt under Code section 501(c)(7), are organized on the basis of a common bond of

religion or ethnic origin. There is no apparent reason to discourage social clubs organized on the basis of a common bond. The practical consequences of denying tax-exempt status to social clubs would be that they would have to file corporate tax returns. Since such clubs would seldom, if ever, have any taxable net income, paperwork burdens would be imposed on both the clubs and the Internal Revenue Service. However, we have been advised by the Internal Revenue Service that the determination of whether an organization has a written policy of discrimination does not present significant problems of administration.

Section three of the enrolled bill amends section 301(g) of H.R. 10612, the Tax Reform Act of 1976, relating to the effective date of the elimination of the tax carryover allowed under present law. Under H.R. 10612 the carryover of unused regular taxes provided by Code section 56(c) from a taxable year beginning before January 1, 1976 shall not be allowed as a tax carryover for any taxable year beginning after December 31, 1975. Section three of H.R. 1144 changes this effective date in the case of corporations which are not electing subchapter S corporations from December 31, 1975 to June 30, 1976. Thus, in the case of such corporations the amount of any tax carryover under Code section 56(c) from a taxable year beginning before July 1, 1976 shall not be allowed as a tax carryover for any taxable year beginning after June 30, 1976. The Treasury Department believes that section three of the enrolled bill is meritorious. The corporate minimum tax amendments of H.R. 10612 were adopted by the Senate on June 24, 1976 as part of a floor amendment. The January 1, 1976 effective date would work a hardship on those taxpayers who had entered into transactions on the basis of then existing law. It was only after the June 24, 1976 decision of the Senate that taxpayers were put on notice that amendment of the corporate minimum tax was anticipated.

Section four of the enrolled bill provides that the Secretary of the Treasury, in cooperation with the Administrator of the Environmental Protection Agency, shall make a study of all provisions of the Code which currently impede or discourage the recycling of solid waste materials, and shall determine what actions Congress may take under the internal revenue laws to increase and encourage the recycling of solid waste materials. The study must be submitted to the President and the Congress "at the earliest practicable date, but not later than six months after the date of the enactment of this Act." The Treasury Department has no objection to this provision. We have already studied the role

of tax incentives in encouraging the recycling of solid waste and have found them to be very costly and, in our opinion, ineffective. A further study of the tax incentives for recycling is not likely to change these findings.

The Treasury Department recommends that the President approve H.R. 1144.

Sincerely yours,

Charles M. Walker
Assistant Secretary

Director, Office of Management and Budget
Attention: Assistant Director for Legislative Reference, Legislative Reference Division
Washington, D. C. 20503

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OCT 12 1976

OFFICE OF THE
ADMINISTRATOR

Dear Mr. Lynn:

This is in response to your request of October 5, 1976, for the Environmental Protection Agency's views and comments on H.R. 1144, an enrolled bill to amend section 501(c)(7) of the Internal Revenue Code of 1954.

Section 4 of this bill provides that the Secretary of the Treasury, in cooperation with the Administrator of the EPA, shall survey and study all provisions of the Internal Revenue Code of 1954 which inhibit resource recovery and conservation and determine what methods under the tax code may be used to enhance the recycling of solid waste materials. Not later than six months after enactment the Secretary would report the conclusions of this study, together with legislative proposals and revenue cost estimates, to the President and the Congress.

Other provisions of H.R. 1144 amend the Code to provide that the deductions allowed under sections 243, 244, and 245 shall be treated as not directly connected with the production of gross income, that deductions relating to dividends received by corporations shall be disallowed to organizations to which the provisions apply, that non-profitable organizations shall not be tax-exempt if they practice discrimination, and that certain tax carryovers will be disallowed. We defer comment to the Department of the Treasury and other concerned agencies on these provisions.

With regard to section 4, we support the policy study requirement of the provision. We believe that a resolution of the conflict over whether current tax policy should be modified to ensure a more efficient use of resources is long overdue. EPA and the Department of the Treasury have already given some consideration to tax obstacles to recycling and resource recovery.

The Environmental Protection Agency has no objection to this bill being signed by the President.

Sincerely yours,

Russell E. Train
Administrator

Honorable James T. Lynn
Director, Office of Management
and Budget
Washington, D.C. 20503

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

Department of Justice
Washington, D.C. 20530

October 6, 1976

Honorable James T. Lynn
Director, Office of
Management and Budget
Washington, D. C. 20503

Dear Mr. Lynn:

In compliance with your request, I have examined a facsimile of the enrolled bill (H.R. 1144) "To amend the Internal Revenue Code of 1954 with respect to the tax treatment of social clubs and certain other membership organizations, to provide for a study of tax incentives for recycling, and for other purposes."

The bill would modify in two respects the requirements which a social club must meet in order to qualify for tax-exempt status. First, Section 501(c)(7) of the Code would be amended to require that "substantially all" of the activities are for pleasure, recreation and other nonprofitable purposes. The present statute requires that the organization be organized and operated "exclusively" for those purposes. While the amendment would permit social clubs to engage in a greater amount of nonexempt activities without risking their exempt status, it appears to be justifiable in view of the provisions of the Tax Reform Act of 1969 which expanded the reach of the tax on unrelated business income.

Second, the bill would deny exempt status to a social organization if its charter, bylaws, or other governing instrument or any written policy statement of the organization includes a provision which provides for discrimination on the basis of race, color or religion. In McGlotten v. Connally, 338 F. Supp. 448 (D.C. D.C., 1972), the Court held that the present statutory scheme was not unconstitutional by reason of failing to tax discrimination by Section 501(c)(7) organizations. The stated purpose of the amendment is that "it is inappropriate for a social club or similar organization described in Sections 501(c)(7) to be exempt from income taxation if its written policy is to discriminate. * * *." H. Rep. No. 94-1353, supra, p. 8. This limited modification of the existing statutory scheme is desirable.

The bill would deny corporate dividends received deductions to exempt social clubs (for purposes of computing unrelated business income) and nonexempt social and membership organizations. These amendments were apparently drafted at the suggestion of the Department of the Treasury. We agree that the current provisions, which allow such deductions, are undesirable, and that their amendment is desirable.

The bill also includes two provisions nongermane to the main thrust of the legislation. One of these provisions modifies the effective date provisions contained in Section 301(g)(2) of the Tax Reform Act of 1976, concerning the phase-out of tax carryovers for minimum tax purposes. This amendment appears to extend for six months the phase-out relative to all corporations other than Subchapter S corporations and personal holding companies. We do not know the rationale for this provision or whether it is intended to benefit a specific taxpayer.

The other nongermane provision would require the Secretary of the Treasury to submit a report to the President and the Congress concerning provisions of the Internal Revenue Code which currently impede or discourage the recycling of solid waste materials.

In view of the two nongermane provisions of the bill, the Department of Justice defers to the Department of the Treasury as to whether this bill should receive Executive approval.

Sincerely yours,

Michael M. Uhlmann

Michael M. Uhlmann
Assistant Attorney General
Office of Legislative Affairs

UNITED STATES COMMISSION ON CIVIL RIGHTS

Washington, D. C. 20425

October 5, 1976

Mr. James M. Frey
Office of Management and Budget
Assistant Director for
Legislative Reference
7201 New Executive Office Bldg.
Washington, D.C. 20503

Dear Mr. Frey:

Within the last two working days, your office, in accordance with OMB Circular A-19, has requested the views and recommendations of the Commission on Civil Rights on five enrolled bills. The enrolled bills are: H.R. 13367, the "State and Local Fiscal Assistance Amendments of 1976"; H.R. 12566, the "National Science Foundation Authorization Act, 1977"; S. 2278, the "Civil Rights Attorney's Fees Awards Act of 1976"; H.R. 11337, amendment of Title 13, United States Code to provide for a mid-decade census of population and for other purposes; and H.R. 1144 which amends the Internal Revenue Code of 1954 with respect to the tax treatment of social clubs and certain other membership organizations.

Although the Commission on Civil Rights appreciates the opportunity and recognizes its responsibility to comment on pending legislation related to its substantive jurisdiction, I must inform you that we cannot comply with your requests for views on the five enrolled bills. Several of the enrolled bills involve matters which have not been formally considered by the Commission and which cannot be considered by the Commission within the specified two-day reply period. Moreover, the Staff Director's absence from the office because of previously scheduled Commission business makes it impractical for the agency to comment within the specified period on those bills which involve matters of established Commission policy.

If you have any technical questions about the enrolled bills which appropriately can be answered by Commission staff, please contact me at 254-6626.

Sincerely,

JAMES J. LYONS
Acting Director
Congressional Liaison

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: October 15 Time: 1245pm

FOR ACTION: Paul Leach
Bill Seidman
Max Friedersdorf
Bobbie Kilberg
Alan Greenspan

cc (for information): Jack Marsh
Ed Schmults
Steve McConahey
Mike Duval

FROM THE STAFF SECRETARY

DUE: Date: October 18 Time: 930am

SUBJECT:

H.R.1144-Tax Code Amendments and Study of Tax Incentives for Recycling

ACTION REQUESTED:

_____ For Necessary Action
_____ For Your Recommendations
_____ Prepare Agenda and Brief
_____ Draft Reply
x
_____ For Your Comments
_____ Draft Remarks

REMARKS:
please return to judy johnston,ground floor west wing

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James M. Cannon
For the President

THE WHITE HOUSE

MEMORANDUM WASHINGTON LOG NO.:

Date: October 15 Time: 1245pm

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Bill Seidman
Max Friedersdorf
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Mike Duval

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ACTION REQUESTED:

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James M. Cannon
For the President

THE WHITE HOUSE

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X For Your Comments
____ Draft Remarks

REMARKS:

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No objection -- Ken Lazarus 10/15/76

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James M. Cannon
For the President

THE WHITE HOUSE

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Bill Seidman
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FROM THE STAFF SECRETARY

DUE: Date: October 18 Time: 930am

SUBJECT:

H.R.1144-Tax Code Amendments and Study of Tax Incentives for Recycling

ACTION REQUESTED:

___ For Necessary Action ___ For Your Recommendations

___ Prepare Agenda and Brief ___ Draft Reply

x
___ For Your Comments ___ Draft Remarks

REMARKS:
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Recommend approval.
Enc

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James M. Cannon
For the President

:TION MEMORANDUM WASHINGTON LOG NO.:

Date: October 15 Time: 1245pm

FOR ACTION: Paul Leach
Bill Seidman
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Alan Greenspan

cc (for information): Jack Marsh
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Mike Duval

FROM THE STAFF SECRETARY

DUE: Date: October 18 Time: 930am

SUBJECT:

H.R.1144-Tax Code Amendments and Study of Tax Incentives for Recycling

ACTION REQUESTED:

____ For Necessary Action ____ For Your Recommendations

____ Prepare Agenda and Brief ____ Draft Reply

x
____ For Your Comments ____ Draft Remarks

REMARKS:
please return to judy johnston,ground floor west wing

I recommend approval.

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James M. Cannon
For the President

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

October 20, 1976

MEMORANDUM FOR JAMES M. CANNON

FROM: ALAN GREENSPAN

This is in response to your request for the views of the Council of Economic Advisers on enrolled bill H. R. 1144 "to amend the Internal Revenue Code of 1954 and to provide for a study of tax incentives for recycling."

This bill would:

(1) allow tax-exempt social clubs to receive up to 25% of their income outside their membership with such income being subject to tax;

(2) disallow the corporate dividend deduction now available to tax exempt social clubs;

(3) disallow tax-exempt status to social clubs which discriminate on the basis of race, color, or religion;

(4) delay the effective date by six months of a provision contained in the Tax Reform Act of 1976 relating to the minimum tax paid by corporations; and

(5) require the Treasury Department and the Environmental Protection Agency to report on any disincentive effects the current tax code may have on the recycling of solid waste materials.

The Council of Economic Advisers recommends that the President sign H. R. 1144.

94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 94-1353

TAX TREATMENT OF SOCIAL CLUBS AND OTHER MEMBERSHIP ORGANIZATIONS

JULY 21, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 1144]

The Committee on Ways and Means, to whom was referred the bill (H.R. 1144) to amend the Internal Revenue Code of 1954 with respect to the tax treatment of social clubs and certain other membership organizations, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is as follows:

Page 2, strike out line 15 and all that follows down through line 18, and insert:

(d) The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 2. (a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) PROHIBITION OF DISCRIMINATION BY CERTAIN SOCIAL CLUBS.—Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of race, color, or religion."

(b) The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

I. SUMMARY

This bill amends the requirements for tax exemption for social clubs and similar organizations (including college fraternities and sororities) in two respects. First, the bill provides that "substantially all" of such an organization's activities must be for pleasure, recreation, and other nonprofitable purposes. This change (present law requires such an organization to be organized and operated "exclusively" for these purposes) allows the organization to earn income from nonmember sources to a limited extent and to have a limited amount of investment income (both types of income being subject to tax) without losing its general exemption from income tax. The second change made by this bill provides that such an organization is to lose its tax-exempt status if its charter, by-laws, or other governing instrument or any of its written policy statements contains a provision which provides for discrimination against any person on the basis of race, color, or religion.

In addition, the bill resolves a question about the corporate dividends-received deduction in the case of organizations which are generally exempt but which nevertheless are taxed on their investment income. It disallows this deduction in computing the taxable investment income of social clubs and similar organizations, and of employee beneficiary associations. Similarly, the bill denies the dividends received deduction for investment income of taxable membership organizations.

II. GENERAL STATEMENT

1. Income From Nonmembers And Investment Sources (subsec. (a) of the bill and sec. 501(c)(7) of the Code)

Present law

Among the present law categories of exempt organizations are social clubs and other somewhat similar nonprofit organizations, such as national organizations of college fraternities and sororities. Present law (sec. 501(c)(7)) provides that these organizations must be organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes with no part of the net earnings inuring to the benefit of any private shareholder. The regulations under this provision (Regs. § 1.501(c)(7)–1(b)) state that a club which engages in business is not organized and operated exclusively for nonprofitable purposes and, therefore, is not exempt.

Generally, the Internal Revenue Service has not challenged the exempt status of these organizations if the income derived from providing goods and services to persons other than members and their guests is small in relation to the total activities of the organization. Thus, as an audit standard (Rev. Proc. 71–17, 1971–1 CB 683), the Service has indicated that it generally will not disturb a social

clubs, certain fraternities and sororities, and employees' beneficiary if the club's annual income from outside sources either is not more than $2,500 or is not more than 5 percent of the total gross receipts of the organization. Where gross receipts from nonmember dealings exceed this 5-percent figure, all facts and circumstances are taken into account in determining whether the organization continues to qualify for exempt status. In the case of investment income, the Service applies no percentage rule, but instead looks to whether a substantial part of the club's income is from investment sources club's exempt status solely on the basis of its nonmember activities (Rev. Rul. 66–149, 1966–1 CB 146).

Reasons for change

In the Revenue Act of 1950, because of the competitive problem with taxable businesses, Congress imposed the regular income tax on the income certain tax-exempt organizations receive from active business enterprises which are unrelated to their exempt purposes. Social clubs, national organizations of college fraternities and sororities, and certain other types of tax-exempt organizations were not subjected to the unrelated business income tax imposed at that time.

In its consideration of the Tax Reform Act of 1969, however, because many of the exempt organizations not subject to the unrelated business income tax were engaging in substantial business activity, Congress extended the unrelated business income tax to virtually all of the exempt organizations not already subject to that tax. As a result, social clubs and national organizations of college fraternities and sororities became taxable on all of their unrelated business income.

In addition, the 1969 Act extended the unrelated business income tax, in the case of these social clubs and national organizations of college fraternities and sororities, to cover investment income as well as unrelated business income. Investment income was made taxable in the case of these membership organizations because not to do so would have permitted them to provide recreational or social facilities and services out of revenues other than membership fees and as a result would have permitted individuals to devote investment income, free of tax, to personal activities.

Because of the personal nature of these organizations, the Internal Revenue Service in prior years developed the 5-percent test referred to above in determining whether a social club was properly exempt from tax. Not to have significantly limited the income which could be derived from nonmembers, under the conditions prevailing at that time, would have resulted in nontaxed income being devoted to the personal, recreational, or social benefit of the members of these clubs.

However, since the passage of the 1969 Act, this strict line of demarcation between the exempt and nonexempt activities of social clubs appears unnecessary. Since the passage of the 1969 Act all of the income derived from nonmembers as well as investment income is subject to tax, even though the organization itself is still classified as an exempt organization. Thus, while it is necessary to require that a social club must still be substantially devoted to the personal, recreational, or social benefit of members, the extent to which such a club can obtain income from nonmember sources can be somewhat liberalized. In view of these considerations your committee's bill clarifies existing law to

permit somewhat larger amounts of income to be derived by exempt social clubs from nonmembers and also from investment income sources.

Explanation of provision

The first amendment made by the bill substitutes for the requirement of existing law that clubs which are exempt from tax under sec. 501(c)(7) must be organized and operated "exclusively" for pleasure, recreation, and other nonprofitable purposes, the new requirement that "substantially all" of such a club's activities must be for these purposes.[1]

The effect of this change is twofold. First, it is intended to make it clear that these organizations may receive some outside income, including investment income, without losing their exempt status. Second, it is intended that a social club be permitted to derive a somewhat higher level of income than was previously allowed from the use of its facilities or services by nonmembers without the club losing its exempt status. The decision in each case as to whether substantially all of the organization's activities are related to its exempt purposes is to continue to be based on all the facts and circumstances. However, the facts and circumstances approach is to apply only if the club earns more than is permitted under the new guidelines. If the outside income is less than the guidelines permit, then the club's exempt status will not be lost on account of nonmember income.

Your committee intends that these organizations be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their tax-exempt status. Your committee also intends that within this 35-percent amount not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. In effect, this latter modification increases from 5 percent (current audit standard: Rev. Proc. 71–17) to 15 percent the proportion of gross receipts a club may receive from making its club facilities available to the general public without losing its exempt status. This also means that a club exempt from taxation described in sec. 501(c)(7) is to be permitted to receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmembers so long as the latter do not represent more than 15 percent of total receipts.

Gross receipts are defined for this purpose as those receipts from normal and usual activities of the club (that is, those activities they have traditionally conducted) including charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts), and normal recurring capital gains on investments, but excluding initiation fees and capital contributions. However, where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facility, that income is not to be included in the formula; that is, such unusual income is not to be included in either the gross receipts of the club or in the permitted 35- or 15-percent allowances. Your committee does not intend that these organizations should be permitted to receive, within the 15- or 35-

[1] The bill continues the present law requirement that no part of the net earnings of the organization may inure to the benefit of any private shareholder.

percent allowances, income from the active conduct of businesses not traditionally carried on by these organizations.

Your committee intends that a social club, national organization of a college fraternity or sorority, and any other organization exempt under section 501(c)(7), may receive the full 35-percent amount of its gross receipts from investment income sources (reduced by any amount of nonmember income, discussed above). This means that a national organization of a college fraternity or sorority that has no outside income from permitting the general public to use its facilities may receive investment income up to the full 35-percent amount of its gross receipts. On the other hand, in the case where a social club permits nonmembers to use its club facilities and receives 15 percent of its gross receipts from these nonmember sources, it may receive only up to 20 percent of its gross receipts from investment income.

In the case of the application of the unrelated business income tax to investment income of these organizations, present law (sec. 512(a)(3)) exempts that income which is set aside to be used for religious, charitable, scientific, literary, educational, etc., purposes (the purposes specified in sec. 170(c)(4)) or the reasonable cost of administration of these activities. For purposes of the 35-percent test, your committee intends that this exempt function income be included in both the numerator and the denominator, and if this exempt function income causes the organization to exceed the 35-percent limit, the organization is to lose its exempt status (unless the facts and circumstances of the case warrant otherwise).

If an organization has outside income in excess of the 35-percent limit (or 15-percent limit in the case of gross receipts derived from nonmember use of a club's facilities), all the facts and circumstances are to be taken into account in determining whether the organization qualifies for exempt status. If it is determined that the organization is to lose its exempt status for that year, all of its income, even that received from its membership, is to be subject to tax in that year. In such a case the income received from the club's members (but only this income) could be offset by the cost of services and goods furnished the members (sec. 277).

2. Dividends Received Deduction for Exempt Social Clubs, etc. (subsec. (b) of the bill and sec. 512(a)(3)(A) of the Code)

Present law

Generally, the tax on unrelated business income does not apply to investment income.[2] However, in the case of social clubs, certain fraternities and sororities, and employees' beneficiary associations, "investment income" is included in the tax base. This result is accomplished in the case of these organizations by defining their unrelated business taxable income (sec. 512(a)(3)) as meaning gross income (other than exempt function income) [3] less allowable deductions directly connected with the production of gross income (again excluding exempt function income).

[2] Section 512(b) generally excludes from the term "unrelated business taxable income" passive investment income such as dividends, interest, royalties, and capital gains.

[3] Exempt function income is defined in section 512(a)(3)(B) as gross income from dues, fees, charges, or similar amounts paid by members in connection with the purposes constituting the basis for the exemption of the organization.

One of the deductions allowed corporations in the computation of the regular corporate income tax is the dividends received deduction. Generally, this allows corporations a deduction equal to 85 percent of dividends received from taxable domestic corporations. The proposed Treasury regulations on social clubs, certain fraternities and sororities, and employees' beneficiary associations[4] provide that the dividends received deduction is not allowed for purposes of computing unrelated business taxable income for those organizations, because that deduction is not an expense directly connected with the production of income.

Reasons for change

Treasury representatives have informed your committee that questions have been raised with respect to these proposed regulations, as to whether Congress intended to disallow the dividends received deduction. To clarify this point the Treasury Department has requested Congress to state specifically that the dividends received deduction is not available in the case of investment income of tax-exempt social clubs, certain fraternities and sororities, and employees' beneficiary associations.

The major reason for the dividends received deduction is to avoid two or more corporate taxes on corporate earnings as the income is passed from one corporation to another, in addition to taxing the same amount to individual shareholders when the earnings are paid out as dividends to them. In the case of social clubs, certain fraternities and sororities, and employees' beneficiary associations, however, the individual income tax on shareholders does not apply, since the dividend income received by these organizations is not distributed to the members. In this case since the exempt organization is in effect taking the place of the individual member for tax purposes, it seems appropriate that the tax apply to these organizations in much the same manner as in the case of individual shareholders.

For reasons indicated above, your committee believes that the proposed Treasury regulations disallowing the dividends received deduction are consistent with the intent and structure of the provision (sec. 512(a)(3)) enacted in the Tax Reform Act of 1969, which allows deductions in the case of investment income of social clubs, certain fraternities and sororities, and employees' beneficiary associations only in the case of deductions directly connected with the production of income. Your committee's bill specifically clarifies this point by providing that in these cases the dividends received deduction is not to be considered as directly connected with the production of gross income.

Explanation of provision

The second amendment made by this bill denies a corporate dividends received deduction to tax-exempt social clubs, certain fraternities and sororities, and voluntary employees' beneficiary associations (described in secs. 501(c)(7) and (9)) in computing their "unrelated business taxable income." Under present law the unrelated business taxable income of these organizations is defined as their gross income (excluding any exempt function income) less the deductions under this chapter

[4] Proposed Reg. § 1.512(a)–3(b)(2), published on May 13, 1971 (36 Fed. Reg. 8808, 8809).

"which are directly connected with the production of the gross income" (again excluding exempt function income). The bill specifically provides that the corporate dividends received deduction is not to be considered as a deduction which is "directly connected with the production of gross income."

3. Dividends Received Deduction for Nonexempt Membership Organizations (subsec. (c) of the bill and sec. 277(a) of the Code)

Present law

Under present law (sec. 277, enacted as part of the Tax Reform Act of 1969), in the case of taxable membership organizations the deduction for expenses incurred in supplying services, facilities, or goods to the members is to be allowed only to the extent of the income received from these members. This was provided in order to prevent taxable membership organizations from escaping tax on business or investment income by using this income to provide services, facilities, or goods to its members at less than cost and then deducting the loss from the membership activity against the business or investment income.

Reasons for change

To the extent these organizations receive dividend income which is used to provide services, facilities, or goods to the members the same problem arises in connection with these taxable membership organizations as in the case of the tax-exempt membership organizations described above (sec. 2. Dividends Received Deduction for Exempt Social Clubs, etc.). If the dividends received deduction were available in the case of the tax on the membership organization (in effect providing a substitute for the dividend tax on shareholders) the second, or individual, tax on this income would be avoided in substantially the same way as in the case of the exempt membership organizations (were the provision described above not to be added). Moreover, if nothing were done in this regard in the case of taxable membership organizations, the nontaxable organizations by revoking their exempt status could avoid the tax on this dividend income in this manner.

For the reasons indicated above your committee believes it is appropriate to disallow the dividends received deductions in the case of these taxable membership organizations in the same manner as in the case of the tax-exempt membership organizations referred to above.

Explanation of provision

The third amendment made by this bill denies a corporate dividends received deduction to taxable social clubs and other membership organizations operated primarily to furnish services or goods to members (referred to in sec. 277). These organizations, with certain exceptions set forth in present law, are permitted deductions attributable to furnishing services, insurance, goods, or other items of value to their members only to the extent of the income derived from members or transactions with members. The bill specifically provides that the corporate dividends received deduction (secs. 243, 244, and 245) is not to be allowed to these organizations.

4. Prohibition of Discrimination by Social Clubs, etc. (sec. 2(a) of the bill and new sec. 501(g) of the Code)

Present law

The Internal Revenue Code does not deal explicitly with the question of whether an income tax exemption for social clubs, etc. (i.e., organizations described in sec. 501(c)(7) which are exempt under sec. 501(a)), is incompatible with discrimination on account of race, color, or religion.

It has been held (*McGlotten* v. *Connally*, 338 F. Supp. 448 (D.C., D.C. 1972)) that, in light of the present statutory scheme of income tax treatment of social clubs, etc. (including their treatment under the unrelated business income tax provisions described above), discrimination on account of race is not prevented under the Constitution in the case of an exempt organization merely because described in section 501(c)(7).[5]

Reasons for change

Your committee concluded that it is inappropriate for a social club or similar organization described in section 501(c)(7) to be exempt from income taxation if its written policy is to discriminate on account of race, color, or religion.

Explanation of provision

Under the bill, an organization otherwise exempt from income tax as an organization described in section 501(c)(7) is to lose its exempt status for any taxable year if, at any time during that year, the organization's charter, by-laws, or other governing instrument, or any written policy statement contains a provision which provides for discrimination against any person on the basis of race, color, or religion.

5. Effective dates (subsec. (d) of the first sec. and sec. 2(b) of the bill)

The amendments made by this bill apply to taxable years beginning after the date of enactment of this Act.

The amendment as to income from nonmembers and investment sources, and the amendments as to the corporate dividends received deduction are clarifications of existing law under the Tax Reform Act of 1969.

III. EFFECT OF THE BILL ON THE REVENUES AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect of this bill on the revenues. Your committee estimates that this bill will result in a small revenue gain, probably less than $100,000 per year. The Treasury Department agrees with this statement.

[5] In that same decision, the court held that, in the case of fraternal beneficiary societies operating under the lodge system, discrimination on account of race is inconsistent both with such an organization's tax-exempt status (sec. 501(c)(8); this may also apply as to sec. 501(c)(10)) and also with its status as a limited charitable contribution donee (sec. 170(c)(4)).

Also, the Supreme Court has affirmed (*Coit* v. *Green*, 404 U.S. 997 (1971)) a decision (*Green* v. *Connally*, 330 F. Supp. 1150 (D.C., D.C. 1971)) that discrimination on account of race is inconsistent with an educational institution's tax-exempt status (sec. 501(c)(3)) and also with its status as a charitable contribution donee (sec. 170(c)(2)).

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote of the Committee on the motion to report the bill. This bill, as amended, was ordered reported by voice vote.

IV. OTHER MATTERS REQUIRED TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the following statements are made:

With respect to subdivision (A), relating to oversight findings, it was as a result of your committee's oversight activity concerning the effects of the Tax Reform Act of 1969 on certain types of exempt organizations and nonexempt membership corporations that the committee concluded that the provisions of this bill are appropriate so as to clarify the status and tax liability of those organizations.

With respect to subdivision (B), after consultation with the Director of the Congressional Budget Office, your committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

With respect to subdivision (C), the Director of the Congressional Budget Office has not made an estimate or comparison of the estimates of the cost of H.R. 1144 but has examined the committee's estimates and agrees with the methods and the dollar estimates resulting therefrom.

With respect to subdivision (D), your committee advises that no oversight findings or recommendations have been submitted to your committee by the Committee on Government Operations with respect to the subject matter of H.R. 1144.

In compliance with clause 2(l)(4) of Rule XI of the Rules of the House of Representatives, your committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

V. Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 277. DEDUCTIONS INCURRED BY CERTAIN MEMBERSHIP ORGANIZATIONS IN TRANSACTIONS WITH MEMBERS.

(a) General Rule.—In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. *The deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year.*

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Subchapter F—Exempt Organizations

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PART I—GENERAL RULE

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SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(a) Exemption From Taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) Tax on Unrelated Business Income and Certain Other Activities.—An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II, III, and VI of this subchapter, but (notwithstanding parts II, III, and VI of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):

(1) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

(2) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized [and operated exclusively for pleasure, recreation, and other nonprofitable purposes] *for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and* no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(10) Domestic fraternal societies, orders, or associations, operating under the lodge system—

(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

(B) which do not provide for the payment of life, sick, accident, or other benefits.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(14) (A) Credit unions without capital stock organized and operated for mutual purposes and without profit.

(B) Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of, shares or deposits in—

(i) domestic building and loan associations,

(ii) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(iii) mutual savings banks not having capital stock represented by shares.

(C) Corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in clause (i), (ii), or (iii) of subparagraph (B); but only if 85 percent or more of the income is attributable to providing such reserve funds and to investments. This subparagraph shall not apply to any corporation or association entitled to exemption under subparagraph (B).

(15) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed $150,000.

(16) Corporations organized by an association subject to part IV of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(17) (A) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

(i) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

(ii) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees, and

(iii) such benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or

highly compensated employees. A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(B) In determining whether a plan meets the requirements of subparagraph (A), any benefits provided under any other plan shall not be taken into consideration, except that a plan shall not be considered discriminatory—

(i) merely because the benefits under the plan which are first determined in a nondiscriminatory manner within the meaning of subparagraph (A) are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law (or reduced by a portion of such benefits if determined in a nondiscriminatory manner), or

(ii) merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or

(iii) merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subparagraph (A)) of supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such other plan if such employees were eligible under such other plan, but only if the employees eligible under both plans would make a classification which would be nondiscriminatory within the meaning of subparagraph (A).

(C) A plan shall be considered to meet the requirements of subparagraph (A) during the whole of any year of the plan if on one day in each quarter it satisfies such requirements.

(D) The term "supplemental unemployment compensation benefits" means only—

(i) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(ii) sick and accident benefits subordinate to the benefits described in clause (i).

(E) Exemption shall not be denied under subsection (a) to any organization entitled to such exemption as an association described in paragraph (9) of this subsection merely because such organization provides for the payment of supplemental unemployment benefits (as defined in subparagraph (D) (i)).

(18) A trust or trusts created before June 25, 1959, forming part of a plan providing for the payment of benefits under a pension plan funded only by contributions of employees, if—

(A) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of benefits under the plan,

(B) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees, and

(C) such benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. A plan shall not be considered discriminatory within the meaning of this subparagraph merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(19) A post or organization of war veterans, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions,

(B) at least 75 percent of the members of which are war veterans and substantially all of the other members of which are individuals who are veterans (but not war veterans), or are cadets, or are spouses, widows, or widowers of war veterans of such individuals, and

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(d) Religious and Apostolic Organizations.—The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(e) Cooperative Hospital Service Organizations.—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c) (3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption; data processing, purchasing, warehousing, billing and collection,

food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

(f) COOPERATIVE SERVICE ORGANIZATIONS OF OPERATING EDUCATIONAL ORGANIZATIONS.—For purposes of this title, if an organization is—

(1) organized and operated solely to hold, commingle, and collectively invest and reinvest (including arranging for and supervising the performance by independent contractors of investment services related thereto) in stocks and securities, the moneys contributed thereto by each of the members of such organization, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members,

(2) organized and controlled by one or more such members, and

(3) comprised solely of members that are organizations described in clause (ii) or (iv) of section 170(b)(1)(A)—

(A) which are exempt from taxation under subsection (a), or

(B) the income of which is excluded from taxation under section 115(a),

then such organization shall be treated as an organization organized and operated exclusively for charitable purposes.

(g) PROHIBITION OF DISCRIMINATION BY CERTAIN SOCIAL CLUBS.—Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of race, color, or religion.

[(g)] *(h)* CROSS REFERENCE.—

For nonexemption of Communist-controlled organizations, see section 11 (b) of the Internal Security Act of 1950 (64 Stat. 997; 50 U.S.C. 790(b)).

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PART III—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

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SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) DEFINITION.—For purposes of this title—

(1) GENERAL RULE.—Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

(2) SPECIAL RULE FOR FOREIGN ORGANIZATIONS.—In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be—

(A) its unrelated business taxable income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, plus

(B) its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States.

(3) SPECIAL RULES APPLICABLE TO ORGANIZATIONS DESCRIBED IN SECTION 501(C)(7) OR (9).—

(A) GENERAL RULE.—In the case of an organization described in section 501(c)(7) or (9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b). *For purposes of the preceding sentence, the deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall be treated as not directly connected with the production of gross income.*

(B) EXEMPT FUNCTION INCOME.—For purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived

from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1)), which is set aside—

(i) for a purpose specified in section 170(c)(4), or

(ii) in the case of an organization described in section 501(c)(9), to provide for the payment of life, sick, accident, or other benefits,

including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii). If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph (A), in unrelated business taxable income for the taxable year.

(C) APPLICABILITY TO CERTAIN CORPORATIONS DESCRIBED IN SECTION 501(C)(2).—In the case of a corporation described in section 501(c)(2), the income of which is payable to an organization described in section 501(c)(7) or (9), subparagraph (A) shall apply as if such corporation were the organization to which the income is payable. For purposes of the preceding sentence, such corporation shall be treated as having exempt function income for a taxable year only if it files a consolidated return with such organization for such year.

(D) NONRECOGNITION OF GAIN.—If property used directly in the performance of the exempt function of an organization described in section 501(c)(7) or (9) is sold by such organization, and within a period beginning 1 year before the date of such sale, and ending 3 years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property. For purposes of this subparagraph, the destruction in whole or in part, theft, seizure, requisition, or condemnation of property, shall be treated as the sale of such property, and rules similar to the rules provided by subsections (b), (c), (e), and (j) of section 1034 shall apply.

(4) SPECIAL RULE APPLICABLE TO ORGANIZATIONS DESCRIBED IN SECTION 501(C)(19).—In the case of an organization described in section 501(c)(19), the term "unrelated business taxable income" does not include any amount attributable to payments for life, sick, accident, or health insurance with respect to members of such organizations or their dependents which is set aside for the purpose of providing for the payment of insurance benefits or for a purpose specified in section 170(c)(4). If an amount set aside under the preceding sentence is used during the taxable year for a purpose other than a purpose described in the preceding sentence, such amount shall be included, under paragraph (1), in unrelated business taxable income for the taxable year.

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H.R. 1144

Ninety-fourth Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Monday, the nineteenth day of January, one thousand nine hundred and seventy-six

An Act

To amend the Internal Revenue Code of 1954 with respect to the tax treatment of social clubs and certain other membership organizations, to provide for a study of tax incentives for recycling, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 501(c)(7) of the Internal Revenue Code of 1954 (relating to exempt organizations) is amended to read as follows:

"(7) Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder."

(b) Section 512(a)(3)(A) of such Code (relating to unrelated business taxable income) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall be treated as not directly connected with the production of gross income."

(c) Section 277(a) of such Code (relating to deductions incurred by certain membership organizations in transactions with members) is amended by adding at the end thereof the following new sentence: "The deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year."

(d) The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 2. (a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(g) PROHIBITION OF DISCRIMINATION BY CERTAIN SOCIAL CLUBS.—Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of race, color, or religion.".

(b) The amendment made by subsection (a) shall apply to taxable years begining after the date of the enactment of this Act.

SEC. 3. (a) Paragraph (2) of section 301(g) of the Tax Reform Act of 1976 (relating to effective date for minimum tax provisions) is amended to read as follows:

"(2) TAX CARRYOVER.

"(A) IN GENERAL.—Except as provided in subparagraph (B), the amount of any tax carryover under section 56(c) of the Internal Revenue Code of 1954 from a taxable year beginning before January 1, 1976, shall not be allowed as a tax carryover for any taxable year beginning after December 31, 1975.

"(B) Except as provided by paragraph (4) and in section 56(e) of the Internal Revenue Code of 1954, in the case of of a corporation which is not an electing small business corporation (as defined in section 1371(b) of such Code) or a personal holding company (as defined in section 524 of such Code), the amount of any tax carryover under section 56(c) of such Code from a taxable year beginning before July 1, 1976, shall not be allowed as a tax carryover for any taxable year beginning after June 30, 1976.".

(b) The amendments made by subsection (a) shall take effect on the date of the enactment of the Tax Reform Act of 1976.

SEC. 4. (a) The Secretary of the Treasury, in cooperation with the Administrator of the Environmental Protection Agency, shall make a thorough and complete study and investigation of all provisions of the Internal Revenue Code of 1954 which currently impede or discourage the recycling of solid waste materials, and shall determine what actions Congress may take under the internal revenue laws to increase and encourage the recycling of solid waste materials.

(b) The Secretary of the Treasury shall report his findings, together with specific legislative proposals and detailed revenue cost estimates, to the President and to the Congress at the earliest practicable date, but not later than six months after the date of the enactment of this Act.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.